# *Agriculture in Eastern Europe:*
# CLEAR PRIORITIES AND MIXED MESSAGES

**by M. Ann Tutwiler**

Transforming centrally planned agrifood systems in Central and Eastern Europe and the Soviet Union into market-oriented systems presents a formidable challenge. Meeting that challenge is critically important. Agriculture accounts for, on average, 15 percent of national income and employment in these countries; food supply and food prices are extremely visible indicators of their economic vitality; and the sector is extremely inefficient, yet has enormous potential.

At present, the agrifood systems in the region are in the midst of this vast transition, and the overarching feeling is that everything must be done at once. Yet, stepping back from the melee, fairly clear priorities for governments, investors, and donors emerge. What is less clear is whether the countries in the region will be able to avoid the agricultural policy mistakes of developed market economies or whether they will imitate the other policies that brought the West modern, efficient agrifood systems.

## Priorities for Government

The first priority for government is to ensure a stable and sound macroeconomic environment. Without that, even well-financed and well designed sectoral policies will be ineffective and inefficient. Excessively high interest rates curtail investment in land and farm capital; overvalued exchange rates raise input prices and reduce the value of exports; rigid capital and labor markets prevent resources from flowing out of agriculture as inevitable development occurs; and high inflation destroys the incentives to produce, save, and invest.

In Poland, for example, macroeconomic instability has led to monthly inflation rates of almost 80 percent and has reduced incomes by almost one-third. Tomczak points out that farmers have been particularly hard hit and have been unable to purchase fertilizers and other inputs. As a result, farm production is expected to decline over the next few years. Thus, agricultural policies will be futile unless governments implement a realistic set of macroeconomic policies, grounded in convertible currencies and floating exchange rates.

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A second priority for governments is to ensure greater access into developed country markets, and a more liberal trading regime. There is little point to developing agricultural export capabilities if world markets are saturated and access restricted. Increased access is ever more critical following the unification of the German Democratic Republic and the economic breakdown on the Soviet Union, which together absorbed much of the region's exports. Moreover, governments in the region would be hard pressed to open their markets to Western agricultural products if foreign markets remain closed to them.

A third priority is to bring farm and agribusiness leaders into the policy making process. The governments of Central and Eastern Europe and the Soviet Union have monopolized the formulation of agricultural policy for decades. Communication has been in one direction: from the top down. For policy reform to succeed, it is not enough to move from centralized central planning to decentralized central planning. The democratic process must extend beyond the voting booth to policy consultation with the various agricultural constituencies. Communication must begin to flow from the bottom up.

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A fourth priority is structural reform. The International Monetary Fund's medicine of price liberalization, however necessary, must be taken with a huge dose of restructuring. Liberalizing price while allowing the old structures to remain will squeeze farmers between declining commodity prices on the free market and high input prices set by monopolies. The example of Poland, where prices were freed while the surrounding input and processing industries remained, leaving farmers with rapidly falling incomes, is instructive.

A final priority is to allow the market to function once it is in place. Government leaders, although trying to achieve a market economy, are still imbued with the old command and control style of policy making. They speak of "appropriate" size of farms and industrial firms. In their zeal to privatize and restructure agriculture, there is a risk that appropriate size will be dictated by decree instead of by efficiency. Kabat reports, for example, that the latest draft land law in Czechoslovakia sets a limit of 150 hectares on land holdings and restricts land sales. There is an equal, or greater risk that government leaders might destroy existing farms and firms before viable alternatives have time to emerge. The problem is not to break up collectives and cooperatives; it is what to do with those that are inefficient.

### Priorities for Investors

The first priority for investors in Eastern and Central Europe is food processing. Production is not the problem; harvesting, distribution and processing are. However, throughout the region, the biggest bottleneck where outside investment could help, appears to be in the food processing sector. Without large investments in this sector, economic and structural reforms will not be enough to overcome the agrifood sector's problems. In the Soviet Union, however, the first priorities are storage and transportation.

The second priority for investors is a stable macroeconomic environment and, primarily, the establishment of convertible currencies. This is far more important than any special incentives for foreign investors and is critically important for domestic investors. Not only will special incentives for foreign investment discriminate against domestic investment; but also special incentives risk establishing foreign enterprise enclaves with few links into the domestic economy.

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Equally important is a stable and reliable legal environment. All countries will need new legislation and laws to govern a market economy. But, more important is the need to reassure investors that the rule of law, and not of a government clique, will predominate. The basic legal codes are in place in many countries. Now, governments must convince investors of their sanctity.

A third priority for investors is a rational policy and regulatory environment. Governments are not making policy nor are businessmen making investments in a vacuum. There is keen competition for investment capital. While many factors go into investment decisions, the flow of capital will depend in large part on the costs of complying with regulations and the costs of purchasing inputs in one country versus another. If bureaucracy is too burdensome, regulations too onerous, or the cost of inputs too high, capital will go elsewhere.

A fourth priority for investors is the encouragement of domestic investment. While much attention is lavished on attracting foreign capital, in truth, the funds to restructure agriculture in central and eastern Europe and the Soviet Union must come from within. Governments and international aid agencies are not in a position to undertake this monumental task, nor can foreign investors be expected to provide the bulk of the investment. The region's governments should spend as much effort raising their own domestic savings and investment rates as they do raising foreign capital.

A fifth priority for investors is to encourage government to work with business. There is a myth in market economies that government and business are enemies, and that the government should not be involved in the economy. In socialist economies, there has been a corollary myth that government and business are enemies, and that private enterprise should not be involved in the economy. The truth lies somewhere in between.

The government plays a critical part in market economies. Government must create a nurturing environment for private investment with a functioning physical infrastructure, a stable legal and macroeconomic environment, a functioning credit and capital market, and a social safety net. Government and business must work together to develop policies, to streamline the bureaucracy, and to design regulations that meet the needs for consumer safety and environmental protection without placing unbearable burdens on private enterprise. But business and government must take care that cooperation does not evolve into collusion. The greatest threat to market economies and to democratic systems arises when special groups capture government policy to further their narrow aims. There is a thin line between accepting advice and following orders.

### Priorities for Donors

The first priority for donors is to invest in human capital. While financial assistance is also required, far more important are management training, farmers' exchange programs, and education for working in a market economy. Without sound management, all the financial investment in the world will come to nothing.

The second priority for donors is to establish a functioning banking system and working commodity markets. The lack of these institutes is a primary obstacle to domestic investment. Secondary needs are for infrastructure—such as roads, ports and storage facilities, technology transfers, and institution building. Ironically, these priorities correspond to those most often listed by Western donor agencies. Other priorities of Western donors—policy advice and structural adjustment assistance—are not high on the list of needs of leaders in Eastern and Central Europe.

A third priority for donors is to channel aid and assistance away from the central government to regional local governments and even farmers' organizations and cooperatives. After years of fighting centralized decisionmaking, there are tremendous desire and need to wrest some of the control from the center.

A fourth, and very important priority for donors is to lobby on behalf of increased market access and global liberalization. The most important aid the West can give the agricultural economies in the region is increased market access and an undistorted world market.

### Avoiding the West's Mistakes

The countries of Eastern and Central Europe and the Soviet Union have a golden opportunity to avoid the mistakes of the West as they decide on the best course for agricultural policies. The agricultural policies of developed market economies hardly allow for the free play of markets in agriculture. Moreover, the high cost and the failures of these policies to achieve important goals make them poor candidates for imitation.

Yet, the problems associated with market intervention policies seem distant to policymakers and farmers in eastern and central Europe. The successes of intervention—rising productivity, relatively high farm incomes, and efficient farming sectors—are far more compelling. Reflecting their concerns about the market and their view of the success of market intervention, government and farm leaders from the former command economies speak of market orientation, but outline interventionist policies, such as price guarantee funds, price stabilization funds, export and consumer subsidies. For example, the government of Czechoslovakia has proposed a system of guaranteed prices which are 10 to 50 percent above prevailing prices for wheat, milk, barley, etc. In Hungary, which has arguably gone the farthest in dismantling internal supports, export subsidies are up to 60 percent on some products according to Csaki.

These interventions are not justified by the need for food security or self sufficiency, a rationale used by agricultural protectionists in many countries. Perhaps so many decades under enforced, regional autarky with its attendant shortages made policymakers skeptical of this argument.

Such policies are more often justified by fears that agriculture in the region cannot compete with the efficient systems in the West, so farmers and consumers should be permanently insulated from world markets. Or, protection is justified by traditional infant industry arguments. Farmers in the region can compete—but not yet. A rapid introduction of world market prices (particularly at their current, depressed levels) would force farmers off the land and into the cities. Such dislocation would place impossible demands on social services and would probably lead to demands for agricultural subsidies.

Interventions are also justified by the existence of Western protectionism. Why should the countries of Eastern and Central Europe expose their farmers to the world market that is depressed and distorted by the policies of the United States and the European Community? And, why should they risk a free market in agriculture when no one else (save New Zealand) does? The collapse of the Soviet market and the loss of the East German market are also fueling demands for protection.

Unfortunately, the problems caused by the expensive price support policies used to support farm incomes in the European Community, the United States (and other countries) are just the problems that Hungary, Poland, Czechoslovakia, and others can ill afford. These policies have failed to maintain incomes for smaller, diversified farms; they have failed to reduce the discrepancy in incomes between regions; and they have failed to protect the environment. In particular, price support policies have not revitalized rural areas, because production agriculture, over time, accounts for a smaller and smaller share of rural employment and income.

Western governments and institutions call on the new leaders to learn from the West's mistakes. They urge new governments to avoid policies which distort market prices, and to rely instead on targeted social policies, such as income stabilization schemes, training programs, broadbased rural development programs, and environmental incentives, that are not linked to the price of agricultural commodities. In short, they are asking the new and unstable governments in Central and Eastern Europe and the Soviet Union to do what the established and stable governments in the West have not yet accomplished: to open their agricultural economies to international competition and to design and implement policies that are largely uninvented and untested.

While the advice may be sound, it probably won't be heeded. As misguided as some of the West's policies are, the fragile governments in Central and Eastern Europe cannot afford to use their countries as laboratories for free market experiments in agriculture. Whatever the failings of the West's policies, they brought the West what the citizens of Eastern and Central Europe and the Soviet Union dearly need: modern, efficient, agrifood systems. So, it is not surprising to hear leaders from the region call for market-orientation and praise the Common Agricultural Policy as the model of choice in the same breath.

Calls for creative, market based policies (such as targeting, decoupling, direct income supports) will fall on deaf ears in central and eastern Europe and the Soviet Union as long as governments in developed market economies rely on price supports, import quotas, and export subsidies to support their farmers. Creative, market based policies will not be implemented in eastern Europe while few such policies are operating in Western economies. Finally, these sorts of policies will not be implemented as long as price supports and import quotas bring increased food supplies quickly and manifest their problems slowly. C

## For More Information

Obtain a copy of the book:

*New Food Systems for Central Europe and the U.S.S.R.* edited by the author of this article, M. Ann Tutwiler, with a Foreword by Lord Plumb of Coleshill by writing to:

Dower House Publications
7a Westminster Street, Yeovil
Somerset B A20 1AF, UK.

The special offer price is $39.95 plus $14.90 airmail postage.

The book is the official proceeding of a conference convened by the International Policy Council on Agriculture and Trade (based in Washington, DC) in October 1990 in Budapest.

The book brings together the views of business, government, farm, and academic leaders from 20 countries including those referenced by Ms. Tutwiler in her article.